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UNCLAS SECTION 01 OF 03 CANBERRA 000446

SENSITIVE
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TAGS: EFIN ECON MCAP PGOV AS

SUBJECT: AUSTRALIAN BUDGET PREVIEW: INTO DEFICIT

REF: A) 08 Canberra 490; B) 08 Canberra 1036; C) 08 Canberra 1302

¶1. (SBU) SUMMARY: The upcoming Federal budget (release date May 12) will see a deficit of around A$70 billion (US$53b), due to significantly decreased revenue because of the effects of the global financial crisis and economic downturn. Indications are that the Rudd government's second budget will increase excise taxes, reduce tax concessions for superannuation and health insurance and cut middle class welfare programs to offset an increase to the aged pension and cuts in income tax; it will also impose some cuts on defense spending. Government debt could rise to A$300 billion (25% of GDP) in four years. Although beyond the GOA's ability to avoid, deficits could prove politically unpopular after a long series of surplus budgets. END SUMMARY.

BUDGET SEASON

¶2. (SBU) Budget season is upon Australia. The release of the Federal budget in May is the top event on the Australian political calendar outside of elections, laying out budgetary and political priorities for the GOA during the upcoming Australian fiscal year (July 1-June 30). The 2009-10 budget, to be delivered on May 12, will be the second for Treasurer Wayne Swan and Prime Minister Kevin Rudd Government. Last May, the Rudd Government was criticized (reftel) for not cutting taxes enough. Economic events, however, subsequently showed that the budget was not too cautious after all; indeed the GOA's cautious projections turned out to be wildly optimistic after the global financial crisis intensified in September.

¶3. (SBU) Although the budget itself remains veiled in secrecy until formally delivered, there are the usual copious leaks and hints, although surprises on the actual day are not unusual. Swan himself has said the budget will include a third round of stimulus measures to counter the recession, and reforms to address costs associated with Australia's ageing population. Last year's budget was initially in surplus, but fell into deficit after the onset of the global financial crisis. This year, Swan says there will be a "temporary" budget deficit of A$50-70 billion (US$38-53b), but he stresses the GOA will bring back the surplus in a responsible way. Swan said the first priority in the current economic climate is "to support the economy, to support jobs", and that (plus reduced government revenues) means a temporary deficit.

¶4. (SBU) Even as the budget slides into deficit, the Rudd Government

has insisted it will find savings where it can, to prevent the deficit from being larger and to ensure the deficit remains temporary. For example, some tax increases and benefit payments are expected. Middle class recipients of benefits such as the private health insurance rebate, Medicare safety net, superannuation tax breaks and the Family Tax Benefit B will be means tested; savings from these reduced payments will help pay for an increase in pensions for the elderly and income tax cuts that were promised last year.

¶5. (SBU) Rudd has admitted some decisions in the 2009-10 budget will
Q5. (SBU) Rudd has admitted some decisions in the 2009-10 budget will
be highly unpopular. Swan said the budget strategy for 2009-10 involves hard choices between helping pensioners and making "nation-building investments to stimulate the economy and to invest in the future." However, Opposition leader Malcolm Turnbull has demanded that Swan "come clean" and explain what six successive deficits would mean for debt.

AUSTRALIA'S FISCAL POSITION

¶6. (SBU) The reasons behind Australia's slide into deficit were factors generally beyond the GOA's control. Due to a collapse in company tax and resource tax revenue, government receipts are forecast to be A$200 billion (US$150b) lower over the next four years than originally envisioned a year ago. The two stimulus packages (refs B and C) which totaled about 5% of Australian GDP alone will cost A$3 billion (US$2.25b) a year in interest charges. Slowing economic growth will also reduce government income and increase fiscal obligations. Australia's net debt could reach A$300 billion (25% of GDP) over 5 years, from an estimated net surplus

position of A$16.2 billion (US$12b) in 2008-09. In February, the GOA forecast a budget deficit of A$35.5 billion in 2009-10, but next week's budget is expected to show a deficit of A$70 billion with no prospect of a return to surplus until 2015-16. Economic forecasts don't show much help coming. The Australian Treasury has predicted GDP growth is expected to be only 0.1% for the 2008-09 FY and up perhaps 0.7% in 2009-10. The unemployment rate is likely to rise to 7.75% by June 2010, from 5.4% in April. However, the latest Reserve Bank report of May 8 forecasts GDP will contract 1.25% in 2009-10, while the IMF has predicted it will drop 1.4 per cent, before growing by a meager 0.6% in 2010.

REPORTS: SOME TAXES AND PENSION RISE, INCOME TAXES FALL

¶7. (SBU) Prime Minister Kevin Rudd has reaffirmed the budget will deliver income tax cuts promised during the 2007 election campaign. These will provide tax relief of almost A$60 a week (US$2300/year) for high-income earners over the next two years. To help fund these tax cuts, there will be excise increases for alcohol and tobacco partly on preventive health grounds. Excise could rise by A$2.50 for a packet of cigarettes and A$.15 for a draft beer, bringing in an estimated A$1 billion (US$750m) in additional revenue a year. The first-home buyers' grant (which doubled late 2008 to A$14,000 for first-time buyers of existing homes and tripled temporarily to A$21,000 for new homes) will expire on June 30. However, the grant may be extended in some reduced form since it has helped the building industry. A rise in the aged pension by around A$30 a week is to be funded by cutting tax concessions for wealthy Australians salary sacrificing into retirement savings funds. Those in line for a pay rise include 2.1 million age pensioners (10% of Australia's population), 740,000 disability pensioners, 140,000 carers and 300,000 veterans.

SUPERANNUATION AND HEALTH POLICY ADJUSTMENTS

¶8. (SBU) To encourage greater use of private health care insurance, the Howard government gave all insured taxpayers an annual rebate worth 30% of their premiums, with those aged 65 and older eligible for a refund of up to 40%. Swan will modify the rebate, which will save A$1.9 billion (US$1.4b) a year, and will lift penalties for higher income taxpayers who do not buy private insurance by boosting their Medicare levy surcharges to 1.5% from 1%. This is likely to affect single people earning more than A$74,000 (US$55,500) and

couples on more than A$150,000 (US$113,000) a year. Couples earning more than A$240,000 (US$180,000) will no longer receive these subsidies. An initiative to save A$440 million (US$330m) over four years will cap payments made by Australia's national health system Medicare to specialists that have been identified as exploiting the system by charging excessive fees. At the center of the crackdown will be specialists such as vascular surgeons, obstetricians, and providers of artificial reproductive technology such as IVF specialists. Medicare access to IVF will also be cut back in the Qspecialists. Medicare access to IVF will also be cut back in the budget, with new limits on safety net reimbursements for obstetric treatments, forcing pregnant women who see private obstetricians to pay much more in out-of-pocket costs. In response to questions, Rudd has refused to guarantee non-means-tested rebates for childcare expenses; these too are likely to change.

¶9. (SBU) Currently, 37% of superannuation (retirement account) tax concessions go to the top 5% of income earners. Today, workers aged up to 50 can contribute up to A$50,000 (US$37,500) a year to their super fund at a 15% concessional tax rate instead of paying their individual marginal tax rate. Over 50s can contribute up to A$100,000 (US$75,000) a year towards their superannuation at the lower tax rate. It is anticipated the budget changes will lower the contribution caps from A$50,000 to A$25,000 a year for those under 50, and from $100,000 to $50,000 for the over-50 population.

DEFENSE AND BORDER SECURITY

¶10. (SBU) The budget allows for defense spending cuts of A$20.6 billion (US$15.5b, about 5%) over 20 years, with A$5 billion by ¶2013. This is expected to primarily affect civilian defense contractors. These savings would help fund the A$100 billion equipment expenditure forecast in last week's "White Paper on

Defence." Savings will be in 15 reform streams including purchasing and travel (A$4.4 billion); maintenance (A$4.4 billion); and workforce reforms (A$1.9 billion). These savings will allow the defense procurement budget to increase from A$4.5 to A$5.7 billion a year for the next four years. A "Regional Action Plan" costing up to A$500 million is planned to provide for anti-people smuggling measures. It will increase surveillance off Australia's north-west coast and train surveillance officers in Indonesia and abroad. The Australian Federal Police is expected to receive A$80 million to spend on counter-terrorism measures overseas. The funding is also to finance more boats and aircraft for border security.

¶11. (SBU) COMMENT: Historically, running deficits has been dangerous in the Australian political arena. The previous record public deficit, under the Keating Government in the early 1990s (4.1% of GDP) was very unpopular, and the Howard Government and its Treasurer Peter Costello crowed about its ability to deliver surpluses and cut taxes at the same time. That was, of course, under markedly better economic circumstances than those now facing Rudd and Swan; absent draconian cuts that would exacerbate the economic slowdown, there is no way for Australia to avoid deficit this year. The Australian Labor Party and others are quick to criticize the Howard/Costello approach for squandering much of the revenue boom on popular tax cuts and middle class welfare rather than funding things such as infrastructure and education. Still, while the second Rudd budget is likely to be received somewhat negatively by some Australians grown used to a long series of easy-to-deliver budgetary surpluses, tax cuts, and new benefits, recent polling suggests that most Australians understand and accept, however grudgingly, the economic necessity of a budget deficit, as long as they believe the Rudd government will invest the money wisely. The Opposition will of course use this occasion to slam the Rudd Government's management of the economy and the budget; all will watch to see whether the budget and the Opposition's criticisms put a dent in the consistently high favorable ratings enjoyed by Rudd personally and for his handling of the economy. END COMMENT.

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